THE HILL

US can't afford to cut funding for finance regulation
By Rep. Barney Frank
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Under the guise of deficit reduction, House Republicans are seeking to undo what they realize they cannot do directly: re-deregulate much of the economy, especially — but not only — in the area of derivatives. Under the FY 2012 Republican budget, the two major federal regulatory agencies overseeing derivatives and securities would be left not only unable to accept any of the new responsibilities conferred on them by the financial reform bill but even to carry out the responsibilities with which they were previously charged.

This will be most glaring with regard to derivatives. But it will also mean that efforts to begin oversight of the role of hedge funds in the economy will be negated, and the increased investor protections included in last year's bill will not soon come to fruition. Indeed, investors will be more vulnerable to behavior that is negligent, reckless, or even deliberately fraudulent than they were before the great crash.

Instead of increasing the budget for the Commodity Futures Trading Commission (CFTC) in order to make possible the increased oversight mandated in the financial reform law, the Republican FY 2012 plan cuts funding for the commission to FY 2008 levels. This is approximately one-third lower than FY 2010 amounts, and almost two-thirds below the $308 million that the administration requests.

Proposed cuts to the Securities and Exchange Commission (SEC) cannot be justified by concern for the deficit, because by law the SEC raises through its fee structure whatever it spends. Indeed, under the Republican budget, the SEC would become a profit center for the federal government — and a significant cause of losses for taxpayers because of its inability to function for many investors. The Republican budget is half a billion dollars less than the amount the administration has requested for it to fully carry out its duties.

The effect of this will be particularly devastating regarding derivatives. There are two aspects to our efforts to increase regulation in this field, where the complete absence of regulation made a major contribution to the crisis — remember the credit default swap liabilities of AIG. First, we do not restrict derivatives, and we are particularly respectful of the needs of those who use them in a legitimate way to hedge inputs needed to produce goods or services. But we have required that the pricing of these instruments be made transparent, to the benefit of everybody, and where there is trading going on in derivatives between financial institutions, we give a strong push to having them be subjected to market forces, through clearinghouses and exchanges, rather than to be traded in the opaque way they are now.

We believe the combination of powers we have given the CFTC and the SEC, including the explicit right of the CFTC to use position limits to deal with speculation, will contribute to reducing the extent to which financial shenanigans drive up commodity prices — oil, for example.

On April 5, I had a long-scheduled appointment with the Council of Institutional Investors, which represents large pension funds. They told me they had an agenda that they had been planning to discuss with me, but that a new item had become their most pressing concern — the Republican budget, and the extent to which by disabling the SEC and the CFTC from guarding investments it would put the pension funds of millions of workers at serious risk.

The Republican argument has been that because these agencies did not do a great job in the past in catching fraud, they don't deserve any more money. But this is not a reward for the agencies. It is a recognition of the fact that they have not done nearly as well as they should have in the past, and so we have a process for improving them.

First, in the financial reform bill, we significantly increased the authority of these agencies to regulate financial activity in a transparent, pro-market way. Second, the administration is putting into place people who genuinely believe that it is important for there to be regulatory agencies that respect the market but also respect the need for fairness and openness, and who are dedicated to preventing abuse. None of this will work if the new laws and the new administrators are not adequately funded.

Frank is ranking member of the House Financial Services Committee.